(10)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 896

TEXAS LAND AND MORTGAGE COMPANY, LIMITED,

Petitioner,

vs.

LON ALEXANDER MULLICAN.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

E. L. KLETT,
CHARLES L. BLACK,
Counsel for Petitioner.

INDEX.

Subject Index.

Table of Statutes Cited.

Table of Cases Cited.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 896

TEXAS LAND AND MORTGAGE COMPANY, LIMITED,

Petitioner,

vs.

LON ALEXANDER MULLICAN.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

May it please the Court:

Petitioner, Texas Land and Mortgage Company, Limited, respectfully shows to this Honorable Court:

A.

Summary Statement of Matter Involved.

Texas Land and Mortgage Company, Limited, a British Corporation, petitions this Court to issue its writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit, to review and reverse its decision, holding

contrary to settled Texas law, that a contract made in Texas to pay compensation for use of money for 10 years is usurious and void, where the compensation "chargeable" for only "*several of the years in question*" exceeds the maximum legal rate of 10 per cent per annum, even though the total compensation payable for the *entire 10 year term* that debtor uses, and under the contract is entitled to use, the money is less than 10 per cent per annum for such 10-year term.

In 1935, Respondent, L. A. Mullican, was debtor in a Frazier-Lemke bankruptcy proceeding, and obtained from the Referee an order extending for four years the time for payment of an unpaid balance of $26,495.00 that he stated in his schedule, under oath, he owed Petitioner (R. 5).

Petitioner filed verified proof of claim, covering unpaid balance of principal, interest and attorney's fees, in the amount of $38,829.76 (R. 17).

Thereupon debtor was granted four years in which to pay said debt (R. 36-37).

After debtor had received the benefit of the four year extension, he then asked the Referee to find that the contract to pay interest was usurious and void, and to credit all payments of interest upon principal (R. 44). This the Referee did, and declared the entire debt discharged because the interest payments made during the twenty years debtor used the money exceeded the principal. Accordingly, Petitioner's claim was completely disallowed (R. 91).

Upon a petition for review, the District Court sustained the Referee, and entered judgment discharging the debt (R. 171-172). An appeal by Petitioner to the United States Circuit Court of Appeals for the Fifth Circuit resulted in an affirmance (R. 269). The Circuit Court of Appeals made the erroneous ruling now complained of in overruling Petitioner's specifications of error, to the effect that the con-

tract was not usurious and that the District Court erred in holding that it was usurious because the tax rate plus the interest rate exceeded 10 per cent for only a part of the period borrower was entitled to use the money (R. 262); and in overruling the same contention in Petitioner's Petition for Rehearing (Grounds II and III, R. 271).

The undisputed evidence shows, and the lower courts found, that on December 22, 1922, Respondent borrowed from Petitioner $38,000.00, which he promised to pay to Petitioner 10 years after date, with interest at the rate of 8 per cent per annum, as evidenced by promissory notes executed in Texas and secured by mortgage upon Texas real estate (R. 16, 164). The maximum legal rate of interest in Texas is 10 per cent per annum. The mortgage also obligated debtor to pay, before becoming delinquent, all annual taxes "chargeable" against the notes (R. 165). Although no taxes were ever assessed against the notes or paid by the debtor, nevertheless such "potential" or supposititious "taxes" are deemed a part of the interest "burden", and the amount of tax "chargeable" (although not assessed or collected) each year must be calculated to ascertain the contract interest rate. In the present case such "potential" tax is included as part of the contract interest rate.

The "Agreed Statement of Facts (R. 174-175), upon which the case was tried, sets forth a table showing, by mathematical calculation the correctness of which is not disputed, that the annual 8 per cent interest rate, when added to the "chargeable" or so-called "potential" tax rate, computed for each of the years 1922 to 1932, is less than 10 per cent per annum for the entire 10-year term (R. 174-175).

Upon such agreed facts, the Circuit Court of Appeals held, as did the District Court, that because "the total burden of stipulated interest plus taxes exceeded the 10 per cent maxi-

mum allowed by Texas law during *"five years of the loan period"*, the Respondent *"fully discharged the burden of showing that the contract was usurious under the Texas statute as construed by the Courts of that state"* (132 F. (2d) 242), even though there was no proof that such "total burden" amounted to 10 per cent per annum for the *entire* 10-year period or term debtor used and was entitled to use the money; and even though it expressly appeared that the interest rate calculated for the entire term of ten years was less than 10 per cent per annum.

The holding of the Circuit Court of Appeals on this important question of local law is in clear conflict with applicable local decisions. The settled law of Texas is that the question of usury must be determined by considering the entire interest burden exacted for the entire term of the loan and by dividing the total interest burden by the number of years in the term. Thus the "per annum" *rate* is determined. Before the creditor's contract can be condemned as usurious, it must appear that he has exacted interest at a rate of more than 10 per cent per annum for the entire term or length of time that the debtor is entitled to withhold the money under the contract. The constitutional and statutory provisions governing the subject of usury control the *rate* of interest that may be charged but not the manner or time of paying interest. The parties are free to fix the manner of paying interest in any way they may choose so long as the total interest charged for the entire term does not exceed 10 per cent per annum for that term. The leading Texas cases so holding are:

Mills v. *Johnston*, 23 Texas 308;
Norris v. *Belcher Land Co.*, 98 Tex. 176, 82 S. W. 500;
Investment Co. v. *Grymes*, 94 Tex. 609, 63 S. W. 860;
Nevels v. *Harris*, 129 Tex. 193, 102 S. W. (2d) 1046;

Shropshire v. *Commerce Farm Credit Co.*, 120 Tex. 400, 30 S. W. (2d) 285.

For a further statement as to the rulings made in these cases and in other Texas cases, see heading "Reason Relied on for the Allowance of the Writ, *post*, pp. 8-16.

B.

Basis Upon Which It Is Contended That This Court Has Jurisdiction.

1. The jurisdiction of this Court is invoked under U. S. C. A., Title 28, Sec. 347(a); Judicial Code, Sec. 240, as amended by the Act of February 13, 1925.

2. The date of the judgment of the Circuit Court of Appeals for the Fifth Circuit to be reviewed is December 14, 1942. The opinion of the Court is reported in 132 F. (2d) 241.

A Petition for Rehearing was filed by Petitioner on January 4, 1943 (R. 270), and was entertained and denied on January 11, 1943 (R. 284).

Said petition duly complained of the ruling herein complained of (Grounds II and III, R. 271).

3. As elsewhere pointed out, the Circuit Court of Appeals has decided an important question of local law in a way that is in clear conflict with applicable local decisions, as is specifically shown in subdivisions A and D hereof. Therefore, this Court should entertain jurisdiction under Rule 38, sub. 5(b).

4. It is believed that the following cases sustain the jurisdiction of this Court:

Cities Service Oil Co. v. *Dunlap*, 308 U. S. 208;
Griffin v. *McCoach*, 313 U. S. 498, 504.

C.

Question Presented.

The question presented is whether the Circuit Court of Appeals erred in holding the notes involved to be usurious and void because the compensation "chargeable" (the stipulated interest rate plus the so-called tax rate), for "several of the years in question", exceeded the maximum legal rate of 10 per cent interest per annum, although it appeared from the undisputed evidence and by simple mathematical calculation, that the total compensation or interest "chargeable" (stipulated interest plus the so-called tax rate), for the entire 10-year term of the loan, amounted to less than 10 per cent per annum.

Under the settled Texas rule, the question of usury is determined upon a consideration of three factors: (a) the amount of money borrowed by the debtor; (b) the term that he is entitled to use this money under the contract; and (c) the total compensation (interest) exacted for its use. This total compensation must be averaged over the whole term to determine whether the interest exacted for that term exceeds 10 per cent per annum.

D.

Reasons Relied On for the Allowance of the Writ.

This Court should grant the writ of certiorari to the Circuit Court of Appeals for the Fifth Circuit because that Court "has decided an important question of local law in a way probably in conflict with applicable local decisions." Rule 38, Sec. 5(b).

The earliest Texas case discussing the question of usury here presented is *Mills* v. *Johnston*, 23 Texas 309, decided in 1859. At that time the maximum interest rate in Texas was 12 per cent. It appeared without dispute that the

lender had actually charged 12½ per cent during one year of the loan but that the aggregate amount of interest, averaged for the whole term, was less than 12 per cent. The Court held that the contract was not usurious. We quote from the opinion:

> "The law, in deciding whether a settlement involves usury or not, will look to the whole amount of interest reserved, as distinct from such commissions as are allowable and recoverable by law, and to the whole period of forbearance extended; and if the charges, properly imputable to interest, do not exceed the highest interest allowed by law, for the whole period of forbearance, then the settlement cannot be held to be usurious.
>
> "In applying these principles to the settlement before us, we find that the whole amount of interest reserved * * * does not amount to twelve per cent per annum, upon the sums due, for the whole period of forbearance extended."

The applicable test of usury in such a case was thus stated by the Supreme Court of Texas in *Investment Company* v. *Grymes*, 94 Tex. 609:

> "The question presented is, did the parties embrace in the 120 notes for the use of the principal debt a sum greater than the original debt would produce at ten per cent per annum for the time the payor of the note had the use of the money?"

The 120 notes referred to were interest notes and the question presented, as stated by the Court, was whether they included a sum of money greater than the original debt would produce at 10 per cent "per annum for the time the payor of the note had the use of the money." The test as thus stated was quoted and expressly approved in a leading Texas case, *Shropshire* v. *Commerce Farm Credit Co.*, 120 Tex. 400, 409; 30 S. W. (2d) 282, 285.

In *Nevels* v. *Harris*, 129 Tex. 190, 102 S. W. (2d) 1046, the nominal principal of the loan was $6400.00. The stipulated interest was 8 per cent. But the creditor withheld $320.00 of the principal as a "commission." The Texas Supreme Court held that the actual amount of the loan was only $6080.00 and that the $320.00 called a commission would be treated "as interest charged on the loan of $6080.00". This interest (called commission), having been collected in advance, the debtor claimed that the contract was usurious because, when the $320.00 was added to the 8 per cent stipulated interest, the amount of interest for the first year exceeded 10 per cent. The Court overruled those contentions and held that the $320.00 should be averaged over the entire term of the loan—five years—and that, thus averaged, the interest for the entire term was less than 10 per cent. The following is quoted from the opinion:

> "Of course, we will treat the $320 as interest charged on the loan of $6080.00. At 10 per cent., the highest legal rate, the interest on $6080.00 for one year would be $608.00, and 10 per cent. interest for the five-year period the loan was to run would amount to $3040.00. This sum added to the principal actually loaned, $6080.00, would aggregate $9120.00. This last sum is the maximum amount Stolley could have legally charged, and unless the contract calls for the payment of more than that sum it is not usurious. Adleson *v.* Dittmar Co., supra; Eubanks *v.* Simpson (Civ. App., writ refused) 90 S. W. (2d) 291; Galveston & Houston Inv. Co. *v.* Grymes, 94 Texas 609, 63 S. W. 860, 64 S. W. 778. It is settled by the above authorities that the law limits the amount that may be charged and received for the use and detention of money to not exceeding 10 per cent. per annum on the amount of the contract, and that, 'If the contract for the use and detention of the principal debt is not a sum greater than such debt would produce at 10 per cent. per annum from the time

the borrower had the use of the money until it is repaid it is not usurious.' Adleson *v.* Dittmar Co., supra; Eubanks *v.* Simpson, supra. If we consider this a contract for five years, we, under the same, would have the sum of $6400.00 bearing 8 per cent. interest per annum, or $512.00 interest for each of the five years; or a total of $2560.00 interest. This total interest sum added to the $6400.00 would produce $8960.00. This would be $160.00 less than could have been legally charged for the sum of $6080.00 actually loaned. It follows that considered as a five-year contract the retention of the $320.00 did not render it usurious." (129 Tex. 196; 102 S. W. 2nd 1049).

In *Norris* v. *Belcher Land Mortgage Company*, 98 Tex. 176, 82 S. W. 500, the contract provided for the payment of 11 per cent interest at the end of each of the first three years and 6 per cent interest at the end of the fourth and fifth years. The Court held that this made the interest so stipulated amount to only 9 per cent for the entire term of five years, this rate being arrived at by totaling all the interest charges for the five years and dividing that total by five. Accordingly, the Court held that the stipulated interest was not usurious and remanded the case for another trial on the issue as to whether the contract was usurious because of the presence of a "tax clause."

In *Eubanks* v. *Simpson*, 90 S. W. (2d) 291, cited with approval by the State Supreme Court in *Nevels* v. *Harris*, *supra*, a "commission" withheld by the creditor at the time the loan was made was treated as interest. It was further held that the contract was not usurious because, when the commission was spread over the entire term of the loan (10 years), the total interest was less than 10 per cent per annum for the stipulated term. The Court in its opinion said:

" 'If the contract for the use and detention of the principal debt is not a sum greater than such debt

would produce at 10 per cent. per annum from the time the borrower had the use of the money until it is repaid, it is not usurious. Galveston & H. Inv. Co. v. Grymes, 94 Tex. 609, 63 S. W. 860, 64 S. W. 778.' Southern States Mort. Co. v. Lykes (Tex. Civ. App.) 85 S. W. (2d) 780, 783, writ ref.

"To discuss this case further is merely to rethrash old straws."

The same rule is applied where the question of usury is resolved in favor of the debtor. *Adleson* v. *Dittmar Co.*, 124 Tex. 564, 80 S. W. (2d) 939, was a suit brought under the Texas statute to recover penalties for double the amount of interest paid on a usurious note. The term of the loan was five years. The contract rate was 9.48 per cent per annum—less than the Texas maximum. But the creditor withheld a so-called "commission", which was, in fact, interest and treated by the Texas court as such. The penalty statute limits the collection of penalties to the interest payments made within two years next preceding the filing of the suit. The Court of Civil Appeals held that the commission, having been withheld in advance, should all be charged as interest collected for the first year of the term and, on that theory, further held that no usurious interest was collected during the two years next preceding the filing of the suit and that debtor was not entitled to recover. The Supreme Court reversed that ruling and held that the so-called commission was interest for the entire term, and that when spread over the entire term the interest contracted for exceeded 10 per cent per annum for that term and that, accordingly, the debtor was entitled to recover statutory penalties on account of the interest paid during the two years next preceding the filing of the suit.

The instant case is to be distinguished from numerous Texas cases where a second mortgage was given to secure

the payment of additional interest notes computed over the whole period or term and containing an "acceleration clause" entitling the creditor, upon certain contingencies, to shorten the term and thereby to create a new term and to collect all of the stipulated interest for the use of the money during the new and shortened term, and without a "saving clause" or provision for abatement of interest because of the shortening of the term. *Shropshire* v. *Commerce Farm Credit Company*, 120 Tex. 400, was such a case, and there are later cases following that case. The decisions referred to hold that the acceleration clause renders the contract usurious by placing it in the power of the creditor to shorten the term and to collect excessive interest for the new and shortened term.

In these acceleration clause cases the question of usury is still determined upon a consideration of the entire term the debtor is entitled to use the money; that term being, however, the new and shorter term that the creditor is entitled to create by resort to the acceleration clause. *Shropshire* v. *Commerce Farm Credit Co.*, 120 Tex. 400, 409-410; 30 S. W. (2d) 282, 285. In these cases the usury is found in the fact that the creditor is entitled to collect for the new and shorter term the interest that was stipulated for the original and longer term; or, as stated by the Supreme Court of Texas in the Shropshire case, the manner of payment contracted for "imposes upon the payor *a charge for more time than he had the money.*" (Italics by the Court.)

The "acceleration clause" rule is not invoked or relied upon in this case, and neither the decision of the District Court nor that of the Circuit Court of Appeals was based thereon.

The design of the law is to protect the debtor against an excessive interest charge for the whole term—the actual term as fixed by the contract the parties elected to make—

and not merely for one year, or any other term less than the entire term.

The words "per annum" used in connection with the rate—"ten per cent per annum"—afford only a measure to be applied in calculating the interest charge to be exacted during the term of the loan. The term may be one year or fifty years. The language "ten per cent per annum" does not mean that a loan contract for ten years shall be divided into ten separate years; it does not mean that the interest collected on a 10-year loan shall not exceed 10 per cent during a single year. It means only that the interest exacted during the term of the particular contract, whatever that term may be, and however the interest charge may be paid, shall be no more than 10 per centum per annum for the contract term.

Under the holding of the Circuit Court of Appeals in this case, if a debtor should borrow $1000.00 for ten years, with interest at 8 per cent per annum (the interest for the entire term totaling $800.00), and should promise to pay the interest as follows: $400.00 at the end of the ninth year and $400.00 at the end of the tenth year, then the contract would be usurious, because, under the holding here complained of, the debtor would be promising to pay more than 10 per cent at the end of two of the years of the entire term, although the interest rate for the entire term would be greatly less than 10 per cent. Under that holding, a 10-year contract would be usurious if the creditor was required to pay 11 per cent at the end of the first year and no interest at the end of any other year.

This holding is in conflict with the settled law of Texas as evidenced by the Texas cases before referred to.* No

---

* The Court that decided the instant case did not include any Judge from Texas. The Court was composed of Circuit Judges Holmes from Mississippi and McCord from Alabama, and District Judge Dawkins from Louisiana.

argument is needed to demonstrate that the question decided was an important one of local law.

As before pointed out, this controversy originated as a bankruptcy proceeding filed by the respondent Mullican. It is plain that if the case had been filed and tried in a State court, the settled State rule of decision would have been applied to the facts, with the result that the contract in question would have been upheld as against the charge of usury.

Petitioner prays that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Fifth Circuit, commanding that Court to certify and to send to this Court for its review and determination, a full and complete transcript of the record and all proceedings in the cause numbered and entitled on its docket 10,344, Texas Land and Mortgage Company, Limited, Appellant, v. Lon Alexander Mullican, Debtor, Appellee, and that the judgment of the United States Circuit Court of Appeals for the Fifth Circuit may be reversed and this petitioner may have such other and further relief in the premises as to this Honorable Court may seem lawful and just.

TEXAS LAND AND MORTGAGE COMPANY, LIMITED
By E. L. KLETT,
CHARLES L. BLACK,
Counsel for Petitioner.

(5480)